

3. Study the extract below and answer the questions that follow.

United Kingdom (UK) economy heads for recession as growth slumps

- ❶ After years of boom, official figures on the UK economy published recently will show that actual economic growth has fallen to nearly 0%, leaving the nation close to recession.
- ❷ The Office for National Statistics' figures for economic growth during the second quarter of this year are forecast to show growth of between 0% and 0.3% in the first three months of 2008. That would push the average annual growth in the economy down from 2.3% to about 1.6% – the sharpest deceleration since 1995.
- ❸ The deputy governor of the Bank of England warned that “there is a risk that we are facing a deeper and more prolonged slowdown”.
- ❹ Especially bad retail sales figures for June, after surprisingly good figures in May, show that households are spending less and consumer confidence is weakening. Sales were down 3.9% compared to the previous month – the worst figure since figures began in 1986.
- ❺ The only positive sign comes from exports, helped by a massive 12% **depreciation** in the value of the pound sterling since last summer. However, that will not be enough to save the economy from further problems, as **consumption**, investment, the housing market and public finances are all set to worsen. Unemployment is already increasing, a critical factor in consumer confidence.
- ❻ Amit Kara, of UBS, an investment bank, believes Britain is “very close to a recession”, and Alan Clarke, a UK economist at another bank, BNP Paribas, said “I think there will be a recession from the third quarter of 2008 onwards. The survey data are consistent with stagnant GDP growth as of June. Rising costs and weakening demand have severely squeezed profits and this is expected to continue. This suggests bad news for the second quarter and worse news ahead”.
- ❼ Meanwhile, rapidly increasing inflation may force the Bank of England to raise interest rates from their current level of 5%, another blow to a housing and property market which is already in trouble.

[Source: Sean O’Grady, “Economy heads for recession as growth slumps”,
The Independent newspaper, Friday 25 July 2008. Used with permission.]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) depreciation (*paragraph 5*) *[2 marks]*
 - (ii) consumption (*paragraph 5*). *[2 marks]*
- (b) Using an AD/AS diagram, explain the likely impact on the UK economy of falling consumer confidence (*paragraph 4*). *[4 marks]*
- (c) Using a business cycle diagram and information from the text, explain in which phase of the business cycle (trade cycle) the UK economy appears to be. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the consequences for the UK economy if the Bank of England were to raise interest rates from 5 % as suggested in paragraph 7. *[8 marks]*